

Summary of Consultation Responses – Foreign Branch Taxation

Introduction

1. This document sets out the main issues considered in the consultation document published in November 2010 and in the technical note and draft legislation published in December 2010. It provides a summary of the responses of interested parties to those documents and to draft legislation, and sets out how the Government is taking forward the issues raised through consultation.
2. Along with the November consultation on detailed proposals, consultation on draft legislation was launched on 9 December 2010; both consultations closed on 9 February 2011. 20 responses were received from representative bodies, businesses and a member of the public. The consultations requested comments on the policy design, whether and how the draft legislation could be improved, and on specific issues for legislation.

The Government was grateful to respondents and all submissions have been carefully considered. The final policy design was announced at Budget on 23 March 2011 with legislation included in the Finance Bill 2011, published on 31 March 2011.

Background

3. The Government announced the intention to move to a more territorial basis for taxing the profits of foreign branches in the Emergency Budget in June 2010. A discussion document was published in July 2010 and was followed by a consultation document in November 2010 which proposed an opt-in exemption regime for Corporation Tax on profits of foreign branches of UK companies. The exemption will also be available for chargeable gains and will apply to all countries and territories.

Responses of interested parties to the consultation document

General comments

4. The proposals were generally welcomed and respondents considered that the policy would contribute to the overall competitiveness of the UK corporate tax system. There was a strong message that the application of exemption to all countries and territories and the inclusion of chargeable gains enhanced the competitiveness of the regime. Some respondents noted that the opt in exemption provided flexibility and was competitive for all sectors. A number commented that the policy aim to achieve broad alignment with taxation of foreign subsidiaries had been achieved. Some respondents considered that the use of exemption would extend beyond the financial and oil and gas sectors as the measure would remove the disincentive to use a branch structure for international business.

Transitional rule

5. The draft legislation included a transitional rule as part of the exemption regime, because exemption would otherwise prevent the claw-back of relief already given for foreign branch losses, potentially resulting in significant costs for the Exchequer.
6. Most responses acknowledged that a transitional rule was necessary to reduce Exchequer costs, but were concerned that the rules as currently drafted caused uncertainty regarding the timing of entry into the exemption regime and whether profits would become exempt. Respondents suggested that immediate entry into the exemption regime, with claw back for pre-election losses only would provide certainty for business and protection for the Exchequer. Respondents also suggested claw back of a branch's losses by streaming them against the future profits of that branch within the transitional rule to allow more flexibility in a number of specific cases. In order to maintain simplicity for the majority of companies any additional options should be available by election. This issue was discussed at the Working Group on 14 January.
7. The Government noted the concerns raised regarding certainty and the final legislation allows immediate entry into exemption on election and claw back of pre-election losses only. Companies have also been given the option to stream losses to an individual jurisdiction to allow those profits of branches in territories where substantial losses have not been incurred to be exempt.

Anti-diversion rule

8. To protect the UK tax base from the artificial diversion of profits where a company opts in to the branch exemption regime, each of its branches will potentially be subject to anti-diversion rules. Where the anti-diversion rule applies in any year, then there will be a UK CT charge, with credit for foreign tax given in the usual way.
9. The majority of respondents acknowledged that an anti-diversion rule was necessary to protect the Exchequer. However, many thought that the scope of the rules in the draft legislation was too wide and created uncertainty as to how the regime would operate, acting as a disincentive to opt in. A number suggested explicit grandfathering of existing business and a more proportional approach, denying exemption only to those profits arising from transactions which constituted avoidance. Attendees raised these issues at the Working Group meeting on 14 January and were supportive of the grandfathering of existing business and suggested a proportional approach to the rule.
10. The Government accepted the principle of grandfathering existing branches which could not have been set up for the purpose of tax avoidance but felt that this was only appropriate where there had not been substantial change in the branch business. The Government also agreed that a proportionate approach to the transaction leg of the motive test, affecting only profits arising from

“tainted” transactions, would provide adequate protection to the Exchequer and greater certainty to business.

11. Until full Controlled Foreign Company (CFC) reform is legislated the anti-diversion rules in the 2011 Finance Bill will apply to the profits of exempt branches. The Government’s proposals for the application of the reformed CFC rules to branches will be published as part of the CFC document in May.

Loss relief

12. Following the responses to the July discussion document on foreign branches the Government proposed an opt in exemption regime as opposed to a mandatory exemption regime with loss relief and claw-back which was also considered.
13. A number of respondents, including advisers and financial sector companies, suggested that a form of loss relief with claw back should be included as part of the opt in exemption regime. They noted that it would be difficult to determine whether electing into the regime would be beneficial given the difficulty of predicting future profits and losses. These respondents felt that the regime should include relief for an aggregate branch loss, with subsequent claw-back without credit for foreign tax. This would be broadly equivalent to the regime operating in the Netherlands and the respondents felt that this would ensure the regime was globally competitive. Some respondents took the view that without loss relief some businesses would not feel able to opt in, negating any competitiveness advantage.
14. This was discussed at the Working Group meeting on 2 February. There were mixed views as to the importance of loss relief for the competitiveness of branch exemption. Some members suggested that any such provisions should be optional to allow businesses to avoid any associated compliance costs.
15. The Government felt that offering an opt in exemption regime would allow companies to choose between two approaches which both achieve a balanced treatment of profits and losses, thus making it competitive for all sectors. Offering a form of loss relief alongside profit exemption would be more generous and would also go further than the stated policy aim of aligning the tax treatment of branches and subsidiaries.

Capital Allowances

16. Where respondents commented on the treatment of capital allowances there was general support for the proposal to treat any activity carried on both in the UK and a foreign branch as two separate activities, for the purposes of applying capital allowance rules. There were however concerns about the potential for external market valuations to be required on assets that have split use or on election into exemption. Some respondents suggested that the flexibility to disclaim capital allowances that is currently available for credit relief purposes should be retained.

17. This issue was discussed at the Working Group meeting on 22 February. Members were concerned that there would be a disproportionate compliance burden if they were required to keep extensive records for small assets and suggested a de minimis.
18. The Government has taken a pragmatic approach which ensures a balance between minimal compliance costs for business and adequate protection for the Exchequer. Market valuations will only be required on assets above a de minimis cost which have changed use within a specified time before the election. The Government considered that offering businesses the flexibility to disclaim Capital Allowances may hinder the effective application of the anti-avoidance rules.

Life Insurance

19. Whilst the draft legislation did not cover long term insurance business the Government gave a commitment to consult closely with the sector on the reforms to foreign branch taxation.
20. Following discussion with the industry the Government has extended branch exemption to long term insurance business other than Basic Life Assurance and General Annuity Business (BLAGAB).

Investment Companies

21. A small number of respondents thought that the exclusion of investment companies could be viewed as State Aid and questioned the need for the exclusion.
22. In practice it is unlikely that an investment company would have a foreign permanent establishment. The Government was content that the anti-avoidance provisions would adequately protect the Exchequer against artificial diversion of profits and therefore decided to remove the restriction for investment companies. The treatment of investment companies and related permanent establishments will be addressed in the Controlled Foreign Company full reform.

Small companies

23. Several respondents suggested the removal of the restriction of exemption for small companies to those countries with which the UK has a full treaty.
24. The Government views the limitation as ensuring that the Exchequer is protected from the loss of tax through diversion of personal income. Exemption is available for small companies where there is a full treaty. The majority of UK tax treaties are full tax treaties including all those agreed with our main trading partners. Small companies with branches will therefore be able to benefit from the exemption regime.

Commencement date

25. The Corporate Tax Reform document asked if respondents agreed that the new regime should be available for accounting periods commencing on or after a specific date in 2011. The majority of respondents were content with this approach. A few suggested 1 January or 1 April to allow an election for Accounting Periods starting on those dates. Others noted that companies would benefit from some time to consider the impact of the final legislation to allow them to assess the benefits of opting into the regime.
26. The Government has announced that the regime will be available for Accounting Periods beginning on or after Royal Assent, as the earliest date at which the legislation can come into force without needing to retrospectively give effect to an election under the regime.

Representations from individuals

27. One member of the public responded to the consultation. Several other informal responses were received after the closing date. These responses objected to the principle of giving tax reductions to companies in the current economic climate and were concerned that the proposals would act as an incentive for businesses to move profits offshore.
28. The changes to the taxation of foreign branches will help to achieve the Government's aim of creating the conditions that encourage businesses to locate and invest in the UK. This measure ensures that the tax treatment of foreign branches is on a more equal footing with foreign subsidiaries and is designed so that only profits derived from genuine economic activity in an overseas jurisdiction will be exempt from tax in the UK. Anti-diversion rules will prevent branch exemption being used to artificially reduce UK taxable profits.

Annex A

List of Respondents

ABI

Baker Tilly

BBA/AFME

BG Group

BP

BRINDEX

British Chamber of Commerce

Chartered Institute of Taxation,

The City of London Law Society

Deloitte

Diageo

E&Y

Gazprom

IUA

KPMG

The Law Society

PwC

Mr. Rice

Standard Chartered

UK OITC

XL